

UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA

JEFFREY L. NIELSEN; THE EVEREST
GROUP, LTD.; EVEREST DEVELOPMENT
LTD.; EVEREST CONSTRUCTION CO.;
EVEREST PROPERTY MANAGEMENT
CO.; MICHAEL INVESTMENTS; and
HAMLINE AVENUE PROPERTIES, L.L.C.,

Plaintiffs,

v.

CITY OF ROSEVILLE,

Defendant.

Civil No. 98-1625 (JRT/FLN)

**FINDINGS OF FACT,
CONCLUSIONS OF LAW AND
ORDER FOR JUDGMENT**

George O. Ludcke and John D. Bessler, KELLY & BERENS, P.A., 3720
IDS Center, 80 South Eighth Street, Minneapolis, MN, 55402, for
plaintiffs.

John M. Baker and William P. Hefner, GREENE ESPEL, P.L.L.P., 333
South Seventh Street, Suite 1700, Minneapolis, MN, 55402, for defendant.

Plaintiff Hamline Avenue Properties, L.L.C. ("Hamline") brings this action against
the City of Roseville (the "City" or "Roseville") pursuant to Minnesota's Tax Increment
Financing Act, Minn. Stat. §§ 469.174 *et seq.*, alleging that Roseville made improper
expenditures of revenue derived from tax increment. Hamline's claims arise from the

FILED _____
RICHARD D. SLETTEN, CLERK
JUDGMENT ENTD. _____
DEPUTY CLERK _____

City's 1994 decision to extend a Roseville business, known as Computype Inc. ("Computype"), a \$700,000 forgivable loan. This matter came on for trial to the Court beginning on January 31, 2001.¹ Based on the entire record and proceedings, the testimony at trial, and the arguments of counsel, the Court enters the following Findings of Fact and Conclusions of Law.

FINDINGS OF FACT

1. All of the Findings of Fact set forth herein are undisputed or have been proven by a preponderance of the evidence.
2. To the extent that the Court's Conclusions of Law include what may be considered Findings of Fact, they are incorporated herein by reference.
3. Hamline is a Minnesota Limited Liability Company, which owns taxable property in the City of Roseville located at 2218, 2234, 2236 and 2240 Hamline Avenue.
4. Roseville is a municipal corporation.

¹ This case initially included a number of claims by plaintiffs. Counts II (Violation of 42 U.S.C. § 1983, based on the Fourteenth Amendment), III (Violation of 42 U.S.C. § 1983, based on Substantive Due Process), VI (Violation of TIF Laws regarding TIF District No. 10), and VII (Tortious Interference with Business and Economic Relations) of the Complaint were dismissed on summary judgment. The case also included a claim by Hamline and the other captioned plaintiffs against the City for retaliation, based on the First Amendment, pursuant to 42 U.S.C. § 1983 (Count I). That claim was tried to a jury beginning on January 31, 2001. The jury returned a verdict in favor of the City on Count I of plaintiffs' Complaint. Plaintiffs also agreed to dismiss Count IV (Violation of 42 U.S.C. § 1983, based on Fifth and Fourteenth Amendment) before the beginning of the jury trial. The Court then held an additional day of testimony solely on the remaining state law claim (Count V – Violation of TIF Laws, based on Computype Transaction) on March 1, 2001. However, some evidence elicited during the jury trial is also relevant to the bench trial and will be set forth in the Court's Findings of Fact.

5. Tax Increment Financing ("TIF") is a process by which a city may capture the increased tax revenues resulting from a particular real estate development project. Minn. Stat. §§ 469.174-79.

6. A TIF district is a geographic area in which real estate developments are located. Upon creating a TIF district and preparing a TIF plan for that district, a city may direct the increased tax revenues to the city rather than to the county, school district, or other taxing authority that would otherwise share the revenue. The particular city that created the TIF district may then use all or some of that captured tax increment to finance the cost of the development that, when completed, will result in an incremental increase in property taxes.

7. By the end of 1994, Roseville had established fourteen distinct TIF districts.

8. On or about December 28, 1994, the City entered into a set of agreements by which it loaned Computype, a Roseville business, \$700,000. City Council members testified that the loan was made to keep Computype in Roseville and to prevent the migration of jobs to another City.

9. The City Council voted on October 10, 1994 and December 12, 1994 to allow the City staff to execute the final loan documents on behalf of the City.

10. The promissory note, borrower's security agreement, and participation agreement for the Computype loan were executed on December 28, 1994.

11. Before entering into the Computype loan, City staff sought legal advice from Roger Jensen of the law firm Peterson Bell Converse & Jensen, concerning the

legality of the proposed loan. Jensen gave the City staff his opinion that the proposed loan to Computype was legal.

12. The Computype loan included a forgiveness provision, which provided that on the date Computype occupied 80,000 square feet of office or warehouse space in Roseville and employed 112 or more full-time employees, the remaining installment payments of principal and interest on the loan would be forgiven. The provision also explained that forgiveness of the loan payments would continue through November 1, 2001, unless Computype no longer met the two forgiveness conditions.

13. An October 10, 1994 Request for Council action prepared by City staff stated that the Computype loan would be funded from the City's TIF-pool of money for the calendar year 1995.

14. At the City Council meeting of October 10, 1994, City Manager Steven Sarkozy explained that the money for the loan would come from pooled money that is available for economic development purposes that was part of the tax increment program.

15. At the December 12, 1994, City Council Meeting, Roseville Finance Director Ed Burrell indicated to the Council that the Computype loan would be paid out of the City's economic development funds.

16. The City paid the \$700,000 in loan proceeds to Computype in four installment payments from January 31, 1995 through May 31, 1995.

17. At the time the City approved the Computype loan and extended the loan proceeds to Computype, the City's accounting practice was to segregate TIF revenue from the City's general fund into special accounts. However, in addition to the TIF

revenue that was placed into those separate accounts, the City also placed the interest that it earned on TIF revenue into those accounts. Also included in those separate accounts were fees the City charged for the use of its name on industrial revenue bonds and other incidental revenue such as sign revenue and developer repayments.

18. The accounts into which the City put its TIF revenue, interest earned on TIF and the other incidental revenue described above were generally known as the City's economic development funds. That group of funds included the Economic Increment Construction Fund, the Tax Increment Project Fund, the Tax Increment Debt Service Fund, a Housing and Revolving loan sub-fund, as well as other funds.

19. By 1994 the City was accumulating several million dollars of tax increment revenue and interest earned on that TIF revenue above and beyond the sums required to service the City's tax increment bond debt.

20. At the time Roseville made the Computype loan, in the beginning of 1995, the City had \$2,944,711 of non-TIF revenue available in its economic development funds. At the beginning of 1996, 1997 and 1998, Roseville had \$4,675,418, \$4,624,672, and \$4,353,586 respectively.

21. In 1995, the City also transferred \$641,970 of non-TIF revenue from a community development fund into the economic increment construction fund. In 1996, the City received an additional \$503,850 in non-TIF revenue that was placed into the economic development funds.

22. Since its adoption, the Tax Increment Financing Act has included a segregation requirement, which provides that:

The tax increment received with respect to any district shall be segregated by the authority in the special account or accounts on its official books and records or as otherwise established by resolution of the authority to be held by trustee or trustees for the benefit of the holders of the bonds.

Minn. Stat. § 469.177, subd. 5.

23. Prior to July 1, 1997, the City treated interest earned on TIF as non-TIF revenue. However, as noted above, the City commingled the TIF and non-TIF revenue in its economic development funds.

24. In 1997, the Legislature amended the TIF Act to define interest earned on TIF after July 1, 1997 as a form of TIF revenue. Minn. Stat. § 469.174, subd. 25. The amendment provided that "increment," "tax increment," "tax increment revenues," and "revenues derived from tax increment" include "interest or other investment earnings on or from tax increments."

25. In 1996, the Legislature gave the Office of the State Auditor ("OSA") the responsibility of conducting random audits for compliance with the state TIF laws. The Department of Revenue had previously had enforcement responsibility for the TIF Act.

26. Prior to the 1997 legislation, which defined interest earned on TIF as TIF revenue, the OSA had not issued an official written position or finding concerning whether interest earned on TIF should be treated as non-TIF or TIF. The director of the Tax Increment Financing Division of the OSA testified at trial that the OSA had been working under the assumption that interest earned on TIF was to be considered TIF.

27. Computype made seven payments to the City of principal and interest on the loan because it had not yet met the forgiveness conditions contained in the promissory

note. Those payments were made on a monthly basis between November 1, 1995 and May 2, 1996. The total amount of repayment made by Computype to Roseville was \$80,333.32.

28. Beginning in June 1996, Computype met the forgiveness conditions contained in the promissory note; that is, Computype occupied 80,000 square feet of space in the City and had at least 112 full-time employees. The City therefore waived the remaining loan payments pursuant to the terms of the promissory note. On an annual basis since 1996, Computype officials have certified to the City that the forgiveness conditions have continued to be met. As of January 1, 2001, the City had waived \$458,333.15 in payments pursuant to the terms of the promissory note and a balance of \$175,000.21 remained on the note. Before July 1, 1997, \$160,826 had been forgiven by the City.

29. The amount of loan payments forgiven by the City is recorded in the City's records as an "expense." Before the end of 1999, the City "expensed" the amount of the forgiven payments to the economic development funds, which as noted above, contained a combination of TIF and non-TIF revenues. In 1995, the City expensed \$2,493 of the Computype loan, \$58,333 in 1996, and \$100,000 in 1997.

30. In April 1999, the OSA issued its annual tax increment financing report. In that report, the OSA took the official position that all TIF revenue should be fully segregated from all non-TIF revenue.

31. On November 22, 1999, the City Council adopted a resolution requiring that the City segregate all TIF revenue from all non-TIF revenue to comply with the OSA pronouncement of April 1999.

32. From the end of 1999 to the present, the City has "expensed" the amounts of loan forgiveness for the Computype loan against a fund that contains only non-TIF revenue, known as the housing and revolving loan fund. Of the \$458,333.15 in payments that have been waived by the City pursuant to the terms of the Computype loan, \$108,333.29 has been waived after November 22, 1999, when the City's accounts were reorganized.

CONCLUSIONS OF LAW

I. Standing, Jurisdiction and Venue

As an initial matter, Hamline has standing to assert a claim against the City for violation of Minnesota's Tax Increment Act because it is the owner of taxable property in Roseville. Minn. Stat. § 469.1771, subd. 1(a). In addition, the Court has subject matter jurisdiction pursuant to 28 U.S.C. § 1367(a), as the Court had original jurisdiction over plaintiff's § 1983 claim. Venue is proper pursuant to 28 U.S.C. § 1391(b).

II. TIF Act Claim

Minn. Stat. § 469.1771 addresses violations of the TIF Act. In subdivision 3, under the heading "Expenditure of increment," the statute provides that:

If an authority expends revenues derived from tax increments . . . (1) for a purpose that is not a permitted project under section 469.176, (2) for a purpose that is not permitted under section 469.176 for the district from

which the increment was received . . . the authority must pay to the county auditor an amount equal to the expenditure made in violation of the law.

Minn. Stat. § 469.1771, subd. 3.

In this case, Hamline alleges that the City violated Minn. Stat. § 469.1771 by making improper expenditures of TIF revenue in connection with the Computype loan. Hamline does not seek damages in this case, but instead seeks to force Roseville to repay to the Ramsey County Auditor the amount of the alleged illegal expenditure. The City does not dispute that if plaintiff proves that TIF funds were used for the Computype loan, that Roseville would have technically violated the TIF Act. Rather, the City argues that plaintiff's claim is barred by laches and alternatively that if a violation of the TIF Act is found, the Court should abate the amount of any unlawful expenditure pursuant to Minn. Stat. § 469.1771, subd. 4(b), because of the City's good faith and because of the undue hardship that would result from repayment. Roseville also maintains that plaintiff has failed to demonstrate that any "expenditure" of TIF was made that violates the TIF Act.

The primary issue for the Court then is whether Roseville made an "expenditure" of TIF that violated the TIF Act; that is, did Roseville finance the Computype loan with TIF revenue or forgive loan payments from TIF revenue. The burden of proof here is on Hamline to demonstrate, by a preponderance of the evidence, that the Computype loan was paid out of TIF funds or that the amounts the City has forgiven constitute expenditures made in violation of the TIF Act. Minn. Stat. § 469.1771; *Holman v. All Nation Insurance Co.*, 288 N.W.2d 244, 248 (Minn. 1980) ("the party who alleges a given fact also has the burden of proving it"); *In re City of White Bear Lake*, 247 N.W.2d

901, 904 (Minn. 1976) ("the burden of proof generally rests on one who seeks to show he is entitled to the benefits of the statutory provision"). Either showing would be a sufficient "expenditure" of TIF revenue to satisfy Minn. Stat. § 469.1771. In addition to this burden of proof, "there is a strong presumption, although a rebuttable one, favoring action taken by a city." *Arcadia Development Corp. v. City of Bloomington*, 125 N.W.2d 846, 850 (Minn. 1964). The Court concludes that plaintiff has not carried its burden of proof, nor overcome the presumption that the City's actions were proper. The evidence presented to the Court during trial does not persuade it that the City made expenditures in violation of the TIF Act.

The Court notes at the outset that this is a particularly difficult case given the evolving nature of Minnesota's TIF Act during the time period in which the alleged violations occurred. In 1994 and 1995, at the time the City entered into the Computype loan agreement and actually extended the \$700,000 to Computype, there is no evidence that the Department of Revenue, the State agency with enforcement responsibility for the TIF Act, had taken any official position on the issue of whether interest derived from TIF was to be considered TIF or non-TIF.² It was not until 1997 that the State Legislature made clear, through an amendment to the TIF Act, that interest earned on TIF was to be treated as TIF. Minn. Stat. § 469.174, subd. 25. Notably, the Legislature did not make that amendment apply retroactively, but specified that only interest earned on TIF **after** July 1, 1997 was to be considered TIF. The Legislature therefore impliedly agreed that

² There was also no indication at that time in the language or history of the TIF Act regarding whether interest earned on TIF was to be treated as TIF or non-TIF.

municipalities could treat interest earned on TIF before July 1, 1997 as non-TIF. The evidence offered at trial showed that Roseville had treated interest earned on TIF as non-TIF revenue prior the legislative pronouncement in 1997. Accordingly, interest earned on TIF before July 1, 1997 was available for Roseville to use to finance the Computype loan and it was not limited by or subject to the constraints of the TIF Act.

Plaintiff must therefore show that the proceeds of the Computype loan came from TIF revenue and **not** from interest the City earned on TIF revenue. Of course, the City can also prove that forgiveness of the loan payments was "expensed" from TIF revenue. The Court must therefore inquire into the manner in which Roseville accounted for TIF and non-TIF.

The starting point for the Court's analysis is Minn. Stat. § 469.177. It provides that, "[t]he tax increment received with respect to any district shall be segregated by the authority in a special account or accounts on its official books or as otherwise established by resolution of the authority to be held by a trustee or trustees for the benefit of holders of the bonds." Minn. Stat. § 469.177, subd. 5. The City's practice throughout the 1990s was to segregate TIF revenue from the City's general fund by depositing it into a group of separate funds referred to by the City as its economic development funds. However, the TIF revenue was not segregated from **all** other sources of City revenue. The economic development funds also included the interest earned on TIF, IDB fees, and other miscellaneous revenue, which was not included in the City's general fund. The City therefore commingled TIF and non-TIF in its economic development accounts. Moreover, while the City specifically accounted for the money that was deposited into

the accounts, it did not keep specific records regarding whether the money paid from those accounts was TIF or non-TIF revenue.

While this practice seems to frustrate the intention of the segregation provision of the TIF Act, the Court cannot find that the City violated the TIF Act through its accounting procedures.³ The City was not violating the express language of the segregation provision as the statute only requires the City to segregate TIF from the City's general funds, something Roseville was, in fact, doing. At the time the City was commingling TIF and non-TIF revenue, the OSA had not yet expressed an official position on the issue of segregation. Further, it was a common practice during the 1990s for municipalities to segregate TIF revenue from the general fund, but not to segregate it from other non-TIF revenue, such as interest earned on TIF, that was not included in the municipality general fund. Indeed, even the 1999 Tax Increment Financing Report made by the OSA to the Legislature admitted that:

The OSA has found that it is a common practice for a TIF authority to have a separate capital project fund for each TIF district and to deposit into the fund all sources of revenue that will be used to pay for the public investment in the development to be assisted by each TIF district.

...

It appears that many TIF authorities record each deposit of money into the fund as a deposit into a revenue account for that specific kind of money, but do not code the expenditures in the same manner.

...

³ Even if the City had violated the TIF Act by improperly commingling TIF and non-TIF revenue, such a violation would not alone be grounds for the relief sought by plaintiff. In order to warrant the relief sought, plaintiff must show an "expenditure" of TIF revenue that violates the statute. Minn. Stat. § 469.1771, subd. 3.

Most TIF authorities deposited interest earned on tax increment in the same fund as the tax increment, and did not code expenditures so that it can be determined which were made with "raw" tax increment and which were made with interest earned on tax increment.

These are exactly the types of practices the City was engaged in until the OSA clarified its understanding of the "segregation" provision of the TIF Act. Given the fact that Roseville was simply adhering to common TIF practices of the time and that the segregation provision had yet to be clarified, there was nothing illegal or abnormal about the City's practice of commingling TIF, interest earned on TIF, and other miscellaneous revenues in a group of funds distinct from the City's general funds.

This leaves the Court in the position of attempting to discern exactly what revenues were used to pay the Computype loan and what revenues the forgiven loan payments were "expensed" against. The obvious difficulty here is that at the time of the actual loan and during the initial period of repayment, as noted above, the City's practice was to commingle TIF revenue, interest on TIF, and other non-TIF revenue into economic development funds. It was from those economic development funds from which the Computype loan was paid and against which the forgiven payments were "expensed." Each time the City made a payment out of its economic development funds, it did not code the expenditure as "TIF" or "non-TIF," but simply debited that account by the amount of the payment.

At the beginning of 1994, the City had \$2,920,353 of non-TIF revenue in its economic development funds. At the end of that year, the City had \$2,944,711 in non-TIF revenue available. By the end of 1995, that amount increased to \$4,675,418.

Clearly, there was more than ample revenue from which the City could have paid the Computype loan and there is no clear indication from the City's records whether the loan was actually paid from TIF revenue or non-TIF revenue out of the economic development funds.

Plaintiff points to the fact that the City's "Tax Increment Detail" summary for the year ending December 31, 1997 indicates that \$160,826 was allocated to the Computype loan. This, however, does not resolve the issue. At trial, Ed Burrell testified that the items and dollar amounts contained in that summary included a combination of TIF and non-TIF sources. Moreover, Burrell explained during his testimony that it was always his understanding that the Computype loan was to be paid out of the non-TIF revenue in the City's economic development funds, and that TIF revenue was to be expended for other purposes. This testimony is consistent with the contemporaneous statement that he made to the City Council in December 1994 that the Computype loan would be paid from non-TIF sources.

Additionally, there was always sufficient non-TIF revenue in the economic development funds against which the forgiven loan payments were "expensed." Beginning at the end of 1999, after OSA's clarification of the segregation provision of the TIF Act, the City has "expensed" the forgiven loan payments against the housing and revolving loan fund, a fund made up only of non-TIF revenue. Given this factual scenario, the Court simply cannot find that the Computype loan or the waived payments were "expenditures" made in violation of the TIF Act. Plaintiff has not provided the Court with sufficient evidence to show, by a preponderance of the evidence, that an

expenditure of TIF revenue was made on the Computype loan in violation of Minn. Stat. § 469.1771. Accordingly, Count V of plaintiff's Complaint is dismissed with prejudice.

III. Attorney Fees

Both plaintiff and defendant have also moved for an award of attorney fees. Because the Court has concluded that plaintiff did not carry its burden of proof and that defendant is entitled to judgment, defendant is also entitled to costs, including reasonable attorney fees. Minn. Stat. § 469.1771, subd. 1(a) explicitly provides that the "prevailing party in a suit filed under the preceding sentence is entitled to costs, including reasonable attorney fees." The Minnesota Court of Appeals has explained that the fee provision in the statute is not discretionary. *Opus Northwest v. Minneapolis Community Development Agency*, 599 N.W.2d 582, 584-85 (Minn. Ct. App. 1999). Accordingly, as a prevailing party, defendant is entitled to costs, including reasonable attorney fees attributable **only** to the TIF portion of this litigation.

ORDER

Based on the Court's Findings of Fact and Conclusions of Law, **IT IS HEREBY ORDERED** that:

1. Judgment is entered in favor of defendant and against plaintiff Hamline Avenue Properties on Count V of plaintiffs' Complaint [Docket No. 1].
2. Within thirty (30) days of this Order, defendant shall submit an affidavit setting forth the attorney's fees and costs it incurred in connection with the TIF portion of this litigation.

IT IS HEREBY FURTHER ORDERED that:

1. Count IV of plaintiffs' Complaint is dismissed with prejudice.
2. The Clerk of Court is instructed to enter Judgment in favor of defendant and against plaintiffs on Count I of plaintiffs' complaint in accordance with the Jury's verdict dated March 1, 2001 [Docket No. 107].

LET JUDGMENT BE ENTERED ACCORDINGLY.

DATED: August 27, 2001
at Minneapolis, Minnesota.

JOHN R. TUNHEIM
United States District Judge